

MEMORANDUM

February 19, 2009

RE:

Qualified School Construction Bonds

BACKGROUND

In February, 2009, as part of the American Recovery and Reinvestment Act of 2009 (the “*Act*”), Congress enacted Section 54F of the Internal Revenue Code of 1986, as amended (the “*Code*”), permitting a State or local government to issue qualified school construction bonds to finance the construction, rehabilitation, or repair of a public school facility and certain land acquisition costs. Owners of qualified school construction bonds will receive a tax credit if they own qualified school construction bonds on one or more quarterly credit allowance dates. The qualified school construction bonds are governed by Sections 54F and 54A of the Code. This memorandum contains a brief summary of the provisions governing the issuance of qualified school construction bonds.

Owners of qualified school construction bonds are provided a federal income tax credit to offset their regular federal income tax liability, rather than receiving interest on the bonds. The amount of the credit is treated as interest and is included in gross income. The owners will receive the credit if they hold qualified school construction bonds on one or more credit allowance dates. The amount of the credit with respect to any credit allowance date is twenty-five percent of the annual credit determined with respect to the bond. The annual credit is equal to one hundred percent of the product of the credit rate (determined by the Secretary of the Treasury (the “*Secretary*”) for the date on which the bond was sold) multiplied by the outstanding face amount of the bond.

The credit allowance dates are March 15, June 15, September 15 and December 15, and also include the last day on which the bond is outstanding. In the case of a bond issued, redeemed or maturing between credit allowance dates, the amount of the credit will be a ratable portion of the credit based on the portion of the three-month period during which the bond is outstanding. The credit rate is determined daily and is the rate the Secretary estimates will generally permit the issuance of qualified school construction bonds with a specified maturity or redemption date without discount and without interest cost to the qualified issuer. The applicable credit rate is determined as of the first day on which there is a binding, written contract for the sale or exchange of the qualified school construction bonds.

In general, the credit for any taxable year cannot exceed the sum of regular tax liability plus the alternative minimum tax over the sum of most credits allowable under the Code. Any excess credit can be carried to the succeeding taxable year.

QUALIFIED SCHOOL CONSTRUCTION BONDS

Qualified school construction bonds are taxable obligations issued by a State or local government that satisfy certain requirements. The requirements that must be satisfied to constitute an issue of qualified school construction bonds include the following:

- (i) the obligations must be issued by a State or local government within the jurisdiction of which the public school is located pursuant to an allocation of a portion of the nationwide volume limitation (discussed below);
- (ii) 100 percent of the available project proceeds of the issue must be used for the construction, rehabilitation, or repair of a public school facility or for the acquisition of land on which such a facility is to be constructed with part of the proceeds of the issue;
- (iii) the issuer must designate the obligations as qualified school construction bonds; and
- (iv) the obligations must comply with special expenditure rules (discussed below).

Although qualified school construction bonds are taxable obligations, two rules governing tax-exempt bonds issued by State or local governments are applicable to qualified school construction bonds. These rules are the arbitrage rules and restrictions under Section 148 of the Code as modified by Section 54A and the reporting requirements under Section 149(e) of the Code, each of which is discussed below.

100 PERCENT TEST

As discussed above, the Code requires that 100 percent of the available project proceeds of an issue of qualified school construction bonds be used for a public school facility or the acquisition of land for such facility. “Available project proceeds” means the excess of (i) the proceeds from the sale of an issue (and investment earnings thereon) over (ii) the issuance costs financed by the issue (to the extent that such issuance costs do not exceed two percent of such proceeds). Thus, it appears that no more than two percent of the proceeds of an issue can be used for costs of issuance.

SPECIAL EXPENDITURE RULES

As of the date of issuance of the qualified school construction bonds, the issuer must reasonably expect that (i) 100 percent of the available project proceeds of the issue will be spent for one or more qualified purposes within three years of the date of issuance of the bonds (although this period may be extended by the Secretary, if requested prior to the end of the three-year period, due to reasonable cause and if the expenditures for qualified purposes will continue to proceed with due diligence); and (ii) a binding commitment with a third party to spend at least

ten percent of such available project proceeds will be incurred within six months of the date of issuance. To the extent the 100 percent test is not met by the close of the three-year period discussed above, all nonqualified bonds must be redeemed within 90 days of the end of the period. The amount of nonqualified bonds required to be redeemed is determined in the same manner as used under Section 142 of the Code for exempt facility bonds.

SPECIAL ARBITRAGE RULES

The qualified issuer must comply with the arbitrage rules of Section 148 of the Code with respect to the proceeds of the issue. However, an issue will not be treated as failing to comply with the arbitrage rules by reason of any investment of available project proceeds during the expenditure period (*i.e.*, the three year period from the date of issuance).

An issue will also not be treated as failing to comply with the arbitrage rules under Section 148 by reason of any fund that is expected to be used to repay such issue if (i) such fund is funded at a rate not more rapid than equal annual installments; (ii) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (iii) the yield on such fund is not greater than the discount rate used by the Secretary to calculate the maturity limitation of the issue (discussed immediately below).

MATURITY LIMITATION

The maturity of an issue of qualified school construction bonds cannot exceed the maximum term determined by the Secretary. The Secretary will determine the maximum term for bonds issued during a calendar month by using the term that will result in the present value of the obligation to repay the principal on the bond being equal to fifty percent of the face amount of such obligation. Such present value will be determined by using as a discount rate the average annual interest rate of tax-exempt obligations having a term of ten years or more which are issued during the month.

STRIPPED CREDITS

The Secretary is permitted to issue regulations concerning the separation of the tax credit from the underlying bonds. In general, there may be a separation (including at issuance) of the ownership of a qualified school construction bond and the entitlement to the credit with respect to such bond. In the case of any such separation, the credit will be allowed to the person who on the credit allowance date holds the instrument evidencing the entitlement to the credit and not the holder of the bond.

In the case of such separation, the rules of Section 1286 (tax treatment of stripped bonds) will apply to the qualified school construction bond as if it were a stripped bond and to the credit as if it were a stripped coupon.

CONFLICT OF INTEREST

The issuer of qualified school construction bonds must certify that (i) applicable State and local law requirements governing conflicts of interest are satisfied with respect to such issue; and (ii) if the Secretary prescribes additional conflict of interest rules governing the appropriate Members of Congress, Federal, State and local officials, and their spouses, such additional rules are satisfied with respect to such issue.

INFORMATION REPORTING

In connection with the issuance of qualified school construction bonds, an issuer will be required to file with the Internal Revenue Service a report similar to those currently required to be filed with respect to tax-exempt obligations.

VOLUME LIMITATION

The Code restricts the amount of qualified school construction bonds that can be issued nationwide to \$11,000,000,000 in 2009 and \$11,000,000,000 in 2010.

The national limitation is generally allocated among the States in proportion to respective amounts each such State is eligible to receive under Section 1124 of the Elementary and Secondary Education Act of 1965 for the most recent fiscal year ending before such calendar year. The amount each State is allocated under the above formula is then reduced by the amount received by any local large educational agency within the State, as described below. If an amount allocated under this allocation to a State is unused for a calendar year it may be carried forward by the State to the next calendar year.

Forty percent of the national limitation is allocated to large local educational agencies in proportion to the respective amounts each agency received under Section 1124 of the Elementary and Secondary Education Act of 1965 for the most recent fiscal year ending before such calendar year. The term large local educational agency means any local educational agency if such agency is: (i) among the 100 local educational agencies with the largest numbers of children aged 5 through 17 from families living below the poverty level; or (ii) one of not more than 25 local educational agencies (other than in (i) immediately above) that the Secretary of Education determines are in particular need of assistance, based on a low level of resources for school construction, a high level of enrollment growth, or other such factors as the Secretary of Education deems appropriate. Any amount allocated to large local educational agency may be reallocated to the State in which the agency is located. In addition, special allocations are made to possessions of the United States (other than Puerto Rico) and to Indian schools.

RICS ALLOWED TO PASS THROUGH TAX CREDIT BOND CREDITS

A regulated investment company (“*RIC*”) may elect to pass through tax credits received from qualified school construction bonds to shareholders of the RIC.

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WAGE AND LABOR STANDARDS

Wage rate requirements and certain labor standards set forth in Subchapter IV of Chapter 31 of Title 40, United States Code, apply to projects financed with the proceeds of any qualified school construction bond.

EFFECTIVE DATE

The provisions of Section 54F of the Code apply to all qualified school construction bonds issued after February 17, 2009, the date of enactment of the Act.